ARQIS FOREIGN LAW OFFICE

Japan Newsletter

September 2015

Dusseldorf

Munich

Tokyo

Labor Law in Japan: Restructuring Human Resources

An increasingly competitive and cost oriented business environment often requires employers to review and restructure their human resources. Such process may include anything from the revision of salary schemes and compensation conditions to redundancy proceedings or even dismissals. This newsletter highlights some of the legal aspects to be observed when restructuring employment relations, in particular with regard to the adjustment of salary and working hours and the reduction of the company's workforce.

I. Adjusting Salary and Working Hours

1. Salary Reduction

Companies aiming to reduce the monetary benefits of its employees usually face the legal obstacle that, in principle, no unilateral amendment of employment conditions can be made to the detriment of the employees.

As a result, most companies try to agree on the proposed changes with the individual or group of employees concerned. Instead of obtaining the consent of each of the employees concerned, companies may also conclude a labor agreement with the labor union that applies to at least three-quarters of all employees regularly working at the respective workplace. In such case, the labor agreement will be binding on all employees belonging to the employee categories (e.g. factory workers, sales staff, etc.) falling under the scope of application of the labor agreement (Article 17 of the Labor Union Act). In addition, the law provides for certain cost-cutting measures through a reduction of working hours, in particular by introducing flexible working hours to reduce overtime and by shortening regular working hours.

2. Working Hours Reduction

Because the Japanese Labor Standard Law provides for mandatory allowances depending on the number and time of working hours, a reduction of a company's overall salary payments can be achieved by an adjustment of the working hour system of the company.

a) Mandatory Allowances

The following minimum allowances are mandatory and must be paid in addition to the regular hourly salary, with failure to comply with this obligation resulting in penalty or criminal charges. However, with the exception of late-night allowance, these allowances do not need to be paid to employees in a managerial or supervisory position.

- Overtime allowance: 25% of the employees' hourly salary for every working hours exceeding 8 hours per day or 40 hours per week;
- Rest-day allowance: 35% of the employee's hourly salary for every working hour rendered on a statutory rest-day (which the employer is required to grant once per week or four times in four weeks);
- Late-night allowance: 25% of the employee's hourly salary for every working hour rendered between 10 p.m. and 5 a.m.

For overtime work rendered during late-night hours from 10 p.m. to 5 a.m., employers are required to pay an increased overtime allowance of 50% and during holidays of 60%.

Contact:
ARQIS Foreign Law Office
Foreign Law Joint Enterprise with
TMI Associates
Roppongi Hills Mori Tower, 23F
6-10-1 Roppongi
Minato-ku, Tokyo 106-6123
Phone: +81 (3) 6438-2770
Fax: +81 (3) 6438-2777
Email: tokyo@arqis.com
http://www.arqis.com
twitter.com/ARQISTokyo

Employers are moreover required to pay an increased overtime allowance of 50% of the employee's hourly salary for each hour of overtime exceeding the number of 60 overtime hours per month. Alternatively to the increase of overtime allowance, employers can stipulate in a labor management agreement that overtime hours exceeding 60 hours per month are compensated with an allowance of 25% of the employee's hourly salary and additional paid vacation days. In such case, four overtime hours exceeding 60 hours count as one hour of paid vacation. For the time being, companies qualifying as small and medium enterprises are exempted from the increased payment obligation for hours of overtime exceeding 60 overtime hours per month.

For companies with average overtime exceeding between 45 and 60 hours per month, the Labor Standard Law requires employer and employees to make efforts to either reduce the number of overtime hours or increase the overtime allowance.

b) Reduction of Working Hours

In companies where overtime frequently occurs, e.g. due to dealing with different time zones or seasonal business, the employer can propose concluding a labor agreement for the introduction of a "flexible working hour system" or an "irregular working hour system".

aa) Flexible Working Hours and Reduction of Overtime

Under a flexible working hour system, an employee is entitled to decide the start and end of his/her work, provided the employee works during a certain pre-defined core working time and renders a designated number of working hours during a defined calculation period within one month. If certain periods of the day are busier than others, an employer can designate those as working times without requiring the employee to work overtime. The employee can schedule his/her working hours around such times. The core working time and the flexible working periods must be stipulated in a labor agreement. While the flexible working hour system does not alter the number of regular working hours, it will reduce the number of overtime hours and thus cut labor costs.

The irregular working hour system allows the company to average the total working hours rendered during a pre-designated period, such as one month, three months or one year. In this case, working periods with a higher workload resulting in overtime work can be off-set against days where the employee worked less than the regular working hours within the designated period, without the company being obliged to pay for overtime, provided the result of the set-off does not exceed the pre-designated number of working hours during the period. This scheme also achieves a wage cost reduction by flexibly re-allocating overtime

bb) Reduction of Regular Working Hours

A reduction of regular working hours is usually achieved by either (i) an amendment of the rules of employment, (ii) a conclusion of a labor agreement establishing an "emergency work sharing system", or (iii) a reduction or suspension of business operation.

(i) Amendment of the Rules of Employment

The employees' working hours are generally set forth in the individual employment agreement and/or the company's rules of employment. The rules of employment may, in principle, be amended any time by a decision of the respective company's management, but if the amendment is made to the detriment of the employee, the employer must either obtain the affected employees' consent, or demonstrate that the amendment is "reasonable". To this end, the employer needs to explain

- the necessity for the company to reduce the working hours and the salary;
- the low degree of hardship faced by the employees due to such amendment;
- the appropriateness of the new employment conditions; and
- the employer's efforts to proceed with the implementation of the amendment in a fair manner, such as by negotiating in good faith with the employees' representative (or the labor union).

Due to the fact that a reduction of the working hours is usually combined with a salary reduction, such amendment is generally held to be to the detriment of the employees even if the ratio of the salary reduction reflects the ratio of the reduced working hours. Therefore, the consent of the employees should be obtained in order to avoid a later challenging of the reduction of the working hours.

(ii) Labor Agreement on "Emergency Work Sharing System"

Alternatively to the amendment of the rules of employment as described above, the company may conclude a labor agreement to establish a so-called "emergency work sharing system". Such agreement serves to adjust working hours and correspondingly reduce salaries to avoid dismissals to the largest possible extent. To conclude such agreement, employer and employee are required to determine, inter alia, the daily work hours or the number of weekly work days, the period of application of the labor agreement, and the groups of employees to which the agreement shall apply. In addition, the labor agreement needs to stipulate the amount and method of salary reduction and the handling of bonuses and retirement allowances during the applicable term.

Unlike a once-and-for-all amendment of the rules of employment for an indefinite period of time, labor agreements for the reduction of working hours and salaries are generally of temporary nature, thereby easing the negotiation process with the employees. While there are no particular legal restrictions with respect to their term, labor agreements are usually valid for a period of between six months and three years.

(iii) Suspension of Business Operation

With the consent of the employees concerned, a company can principally reduce or suspend its business operation for a certain period of time. During such suspension the employer is required to pay a leave allowance to the employees for the time the business operation is suspended in the amount of at least 60% of the employee's average salary under Article 26 of the Labor Standard Law.

A governmental subsidy of (i) up to two-thirds of such leave allowance for companies falling under the definition of small and medium enterprises stipulated in a guideline of the MHLW and of (ii) half of such leave allowance in case of other companies for a maximum of 100 days during a one year period and 150 days during a three years period may be obtained by the employer under certain conditions, including inter alia an average decrease of business (sales, production etc.) of 10% or more in the last three months in comparison to the previous three months.

II. Workforce Reduction

1. Voluntary Retirement

Whenever a dismissal of employees takes place, the company risks becoming involved in undesired disputes in and/or out of court, the outcome of which usually cannot be safely predicted. In Japan, a dismissal is generally considered to be a method of "last resort" and thus requires a company to make sufficient efforts in order to be avoided. Whether or not a court will ultimately accept the business rationale established by the company as "justifiable cause" for the dismissal remains in most cases uncertain. It is therefore standard practice at most Japanese companies to avoid a dismissal and to seek the employees' "voluntary retirement" whenever possible.

Effecting a voluntary retirement usually requires the company to propose a voluntary termination of the employment in consideration of a severance payment and/or other benefits, such as outplacement services, offered by the company. Generally, the following two schemes are available for offering a voluntary retirement: the employer (a) proposes selected individual employees to voluntarily resign (*"taishoku kanshou"*), or (b) proposes all employees or a specific group of employees an early retirement based on a retirement plan (*"kibou taishoku"*). Both schemes have in common that in case the employee agrees to the voluntary retirement, the employment will be terminated upon mutual settlement agreement concluded between the parties. Such settlement agreement should include a general waiver of claims against the company in order to settle all legal issues between the parties at once.

a) Proposed Resignation (*"Taishoku Kanshou"*)

The voluntary retirement based on a proposed resignation allows the company to address individual employees and encourage them to voluntarily resign. The common approach is to (i) select individual employees who shall resign, and to (ii) propose their resignation in individual meetings by offering a severance payment or other compensation package.

The terms and conditions of the proposal are discussed and negotiated with the individual employees concerned and the final severance package may differ from employee to employee, depending on their length of employment, age and family status and other relevant criteria, but the overall approach must be uniform to avoid any discrimination. It should be noted that there is no particular limitation as to the number of employees who can be addressed by the proposal for resignation and it thus remains at the employer's discretion whether to choose an individual approach or the presentation of a retirement plan to a group of employees (cf. section II.1.b below).

It is generally required to allow for a review and, if necessary, adjustment of the offered terms to demonstrate that the company has made best efforts to accommodate the needs of the employees concerned to the greatest extent possible. The company may generally determine the number and period of negotiation rounds, but while it should demonstrate sufficient effort to negotiate in good faith with the employees the conditions of their retirement, it must not force them into unwanted, continued negotiations.

The retirement must be proposed in a non-coercive manner to avoid the employee claiming that he/she has been "forced" to accept the voluntary retirement by the company, in which case the employee may be entitled to damage compensation claims. This requires the company to give the employee sufficient time to review the proposal for voluntary retirement, as well as to avoid being insistent in case the employee explicitly rejects such proposal. In addition, it is recommendable that meetings with individual employees are attended by a second person to serve as witness.

Established practice confirms that after two to three rounds of good faith negotiations the company usually can demonstrate that it has made sufficient efforts to achieve the voluntary retirement. Only after the last and final offer has been made, dismissal procedures can be initiated with respect to those employees who refuse to accept a voluntary retirement under the conditions proposed by the company.

Whatever effort is made by the company to avoid dismissals by seeking the employees' voluntary retirement, this does, however, not release the company from the requirement to present a justifiable cause for the dismissal, in case it is opting for this method of last resort, as otherwise the dismissal will be rejected as legally invalid in a court proceeding.

b) Retirement Plan ("Kibou Taishoku")

Seeking the voluntary retirement of a designated group of employees on the basis of a retirement plan is the usual approach when a greater number of employees shall be addressed. Instead of selecting specific employees for individual voluntary retirement, the retirement plan defines the scope of application under the criteria determined by the company, such as the employees of a certain division or group, which can be defined by, e.g., age, hierarchy level, qualification, department, and/or nature of job. In addition, the retirement plan sets forth the conditions for the voluntary retirement, such as the amount of severance payment and other benefits.

The usual procedure for the reduction of workforce based on a retirement plan is as follows: (i) the company designates the scope of application of the retirement plan and the conditions for the voluntary retirement, (ii) the terms of the plan are then announced to all employees concerned, and (iii) the retirement plan is verbally explained to the designated employees by encouraging the selected employees to seek voluntary retirement in individual interviews. The situation may differ if a labor union exists requesting that all negotiations shall be held with the union representatives, in which case the company must comply with such request. The period for accepting the proposed plan is commonly set between two weeks and one month and, in case the retirement plan is approved by the employees, the employment is mutually terminated based on an individual settlement agreement with each employee.

If only a few of the designated employees accept the retirement plan, the company may, after the expiration of the acceptance period, propose a voluntary retirement to selected employees on an individual basis following the procedure as described above (cf. section II.1.a above) in order to achieve the desired downsizing before initiating dismissal procedures.

Because the retirement plan is generally addressed to a group of employees, more than the targeted number of employees may accept the offer. In practice, the retirement plan is therefore "announced", similar to an invitation, but not "offered" in the legal sense of soliciting an offer by the employee to retire based on the conditions stipulated in the retirement plan.

2. Dismissal

If an employee refuses to accept a voluntary retirement under the conditions proposed by the company, a dismissal may be pursued as an option of last resort, provided a "justifiable cause" exists. Article 16 of the Japanese Labor Contract Law stipulates that a dismissal which (i) lacks objective rational grounds, and (ii) is not considered appropriate in general social terms, shall be treated as abuse of power and invalidated.

a) "Justifiable Cause"

The following four criteria developed by Japanese courts have to be cumulatively fulfilled if a company aims to restructure its workforce for "business reasons", to establish a justifiable cause for dismissal:

(i) Economic necessity of personnel cuts;

(ii) Demonstration of sufficient prior efforts made by the company to avoid dismissal, such as, without limitation, re-assignments, temporary transfers, restrictions on overtime, freeze on new hires, reduction of directors' salaries, voluntary retirement offered (cf. section II.1. above), and cuts in part-time and other non-permanent positions;

(iii) Stating reasonable criteria for selection of dismissal candidates, e.g. number of late arrivals and absences, history of violation of work rules, degree of economic impact on employees, e.g. those with no dependents etc.; and

(iv) Efforts made to accommodate the employees' concerns by providing adequate explanations, including hearing employees' opinions, regarding the events leading to the (collective) dismissal and the terms and methods of carrying out such dismissal.

If the company cannot demonstrate to have acted in compliance with the above described criteria, it will be at risk to have the dismissal declared legally invalid in a court proceeding, resulting in the employee's reinstatement in his prior employment position with full right to receive continued payment of his salary.

b) Notice Period

The statutory notice period for termination by the employer is 30 days according to Article 20 (1) of the Japanese Labor Standard Law. However, the number of notice days may be reduced by the number of days the company pays the average daily salary in lieu of days of actual work. The termination notice should be delivered in writing for reasons of evidence. The notice should state the overall reason for the dismissal (such as for "business reasons") but does not need to include a detailed statement with respect thereto. The company must however inform the employee of the specific reason for his/her dismissal if this is requested by the employee.

c) Negotiations with the Labor Union

If a labor union has been established and a collective bargaining agreement has been concluded, the company may be obliged to conduct negotiations with the union as well, or through the union exclusively. The Japanese Labor Union Law also provides a general obligation to consult and negotiate in good faith with the union on any matter involving employment conditions, and the company generally has to comply with any such request by the union to negotiate.

d) Notice to Authorities

For mass dismissals neither a particular dismissal procedure nor a specific method of public announcement exists in Japan, except for the report to the local public employment security office to be made in cases where 30 or more employees shall be dismissed at one business location of the company within one month. Such dismissal has to be reported one month prior to the last effective termination of an employee at the latest (Article 27 of the Employment Promotion Law). In addition, a "Second Career Assistance Plan" has to be submitted one month prior to the first effective termination (Article 24 of the Employment Promotion Law). This plan has to include, inter alia, personal information about the employees affected by the termination, such as their name, age, the date of termination of their employment, as well as information about measures the company has taken to assist the employees in finding new employment, e.g. recommendation to business partners etc.

Moreover, according to Article 16 of the Elderly Workers Protection Act in connection with the ordinances of the Ministry of Health, Labor and Welfare, an employer dismissing within one month five or more “elderly” employees, i.e. employees between the age of 45 and 64 years, is obligated to inform the local public employment security office about such dismissal one month prior to the date on which the last termination of employment becomes effective. In case of dismissal of elderly employees, the second career assistance plan has to be submitted to the local public employment security office to the extent such re-employment is desired by the employees.

e) Challenging the Dismissal

If an employee does not accept a dismissal, he/she can in principle seek the support of the competent labor office, the union or its umbrella organization (*Rengou*), and/or initiate court proceedings, i.e. file a lawsuit. In addition, a combined arbitration/mediation procedure in front of a labor tribunal (*Roudou Shinpan*) can be initiated by the employee prior to filing a lawsuit. This labor tribunal procedure is conducted by one professional judge specialized in labor law and two honorary judges, and is usually less time-consuming and cost-intensive than a "formal" court procedure. As a general rule, no more than three hearings will be held by the labor tribunal, generally within three months. In practice, the judge encourages the parties to settle their dispute amicably by concluding a settlement agreement and often proposes a severance payment to the employee in consideration of the case-by-case circumstances. However, neither the employee nor the employer is obliged to conclude a settlement, in which case the labor tribunal renders a judgment which may be challenged before a court by both parties within two weeks.

f) Statute of Limitation for Claims

While Japanese law provides for neither (i) a statute of limitation with regard to the employee's right to challenge the dismissal, nor (ii) a general rule limiting courts in accepting an employee’s claim for unjustified dismissal, the employee may only claim payment of his/her salary from the termination date until his/her re-employment for a period of up to two years, even if the claim is filed several years after the dismissal. Whether a court accepts a claim for unjustified dismissal several years after the dismissal of the employee depends on the circumstances of the case at issue. For example, while a court claim filed by an employee two years and several months after the termination date was rejected, a lawsuit filed by another employee eight years after the termination date was accepted by the competent court.

Our Offices:

Tokyo Office

ARQIS Foreign Law Office
Foreign Law Joint Enterprise with
TMI Associates
Roppongi Hills Mori Tower, 23rd floor
6-10-1 Roppongi, Minato-ku, Tokyo
106-6123 Japan
Phone: +81 (3) 6438-2770
Fax: +81 (3) 6438-2777
tokyo@arqis.com

Düsseldorf Office

ARQIS Rechtsanwälte
Hammer Str. 19
40219 Düsseldorf
Germany
Phone: +49 (211) 13069-000
Fax: +49 (211) 13069-099
duesseldorf@arqis.com

Munich Office

ARQIS Rechtsanwälte
Prinzregentenplatz 7
81675 Munich
Germany
Phone: +49 (89) 309055-600
Fax: +49 (89) 309055-699
munich@arqis.com